IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 232 of 1989

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI
and
Hon'ble MR.JUSTICE K.M.MEHTA

==========

1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

PATEL FILTERS LTD.

Versus

COMMISSIONER OF INCOME TAX

Appearance:

1. INCOME TAX REFERENCE No. 232 of 1989
MR JP SHAH, Advocate with MR MJ SHAH, Advocate for Petitioner
Ms MONA BHATT,Advocate for MR MANISH R BHATT Standing Counsel for the Respondent

---

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE K.M.MEHTA

Date of decision: 25/04/2003

ORAL JUDGEMENT

(Per : MR.JUSTICE R.K.ABICHANDANI)

#. The Income-tax Appellate Tribunal, Ahmedabad Bench "A" has referred the following questions for the opinion of this Court under Section 256(1) of the Income-tax Act, 1961.

"At the instance of the assessee:
R.A. No. 333/Ahd/1989:

[1] Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that scrutiny fees of Rs. 45,000/- paid to GIIC for obtaining a loan for the purchase of machinery and extension of building was not allowable revenue expenditure?

[2] Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the fees of Rs. 4350/- was paid to M/s. Dixit Consultants for preparing a report in connection with the loan from GSFC/GIIC for manufacturing pumps and valves was not allowable revenue expenditure?

[3] Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the amount of Rs. 10,000/- paid to M/s. Parekh Jazal & Co. in connection with the above loan of Rs. 60 lakhs from GIIC was not allowable revenue expenditure?

[4] Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the amount of Rs. 14,800/- paid to M/s. Ambubhai Diwanji & Co., Solicitors in connection with the above loan of Rs. 60 lakhs from GIIC was not allowable revenue expenditure?

[5] Whether, on the facts, and in the circumstances of the case, the Tribunal was right in law in holding that the foreign tour expenses of Rs. 39,496/= and Rs. 85,411/- incurred by the

Managing Director of the company was not allowable revenue expenditure?

[6] Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that electric generator is not an energy saving device and, therefore, is not entitled to 100% depreciation?

At the instance of the Revenue:
R.A. No. 334/Ahd/1989:

Whether, in law and on facts, the Appellate Tribunal is right in deleting the addition of Rs. 4,10,671/- made by the Income-tax Officer invoking the provisions of Section 43B of the Income-tax Act, 1961?"

#. For the previous year relevant to the Assessment Year 1984-85, the assessee filed its return on 28th June, 1984, declaring the profit of Rs. 5,38,885/-. The assessee claimed expenses incurred for the purposes of obtaining loan as revenue expenditure which included a scrutiny fee of Rs. 45,000/- paid to GIIC, amount of Rs. 4,350/- paid to M/s. Dixit Consultants for preparing a report, amount of Rs. 10,000/- paid to M/s. Parekh Jazal & Co. and Rs. 14,800/- paid to M/s. Ambubhai Diwanji & Co., Solicitors, in connection with the loan of Rs. 60.00 lacs from the GIIC. These four items are the subject matter of the first four questions which are referred to us. The Income-tax Officer disallowed these items on the ground that they were capital expenditure because, the loan was obtained by the assessee for acquiring capital asset. The Commissioner of Income-tax (Appeals), maintained the disallowance made by the I.T.O. on the ground that the expenditure related to the loan which was taken for the new line of business and, therefore, was of capital nature.

#. The Tribunal, in the appeal filed by the assessee, following the decision of the Gujarat High Court in Commissioner of Income-tax, Gujarat v. Vallabh Glass Works Ltd., reported in 137 ITR 389, held that the decision of CIT (Appeals) did not call for any interference as it was rightly held by him that the expenditure incurred in in procuring the loan was an integral part of the cost of acquisition of the assessee and cannot constitute an item of revenue expenditure. In respect of all the four items covered under the first

four questions, the Tribunal held that since the expenditure was incurred in connection with the raising of a loan for the purpose of acquisition of capital assets, it could not be treated as a revenue expenditure and was rightly held to be an expenditure of capital nature.

2.1 The learned counsel appearing for the appellant, in this context, strongly contended that, the decision of this Court in CIT v. Vallabh Glass Works Limited, on the basis of which the Tribunal and the authorities below had based their findings was impliedly overruled by the decision of the Supreme Court in the case of Additional Commissioner of Income-tax v. Akkamamba Textiles Ltd., reported in 227 ITR 464, in which the Supreme Court affirmed the decision of the Andhra Pradesh High Court, in the case of CIT (Addl.) v. Akkamamba Textiles Ltd., reported in 117 ITR 294. The Supreme Court dismissed the appeal which was filed by the Revenue against the said decision of the Andhra Pradesh High Court. It was pointed out that in the case of CIT v. Shivakami Mills Ltd. (S.C.), reported in 227 ITR 465, the Supreme Court following the decision in Akkamamba Textiles Ltd. (supra) held that the guarantee commission paid to the bank was revenue expenditure and hence was an allowable deduction in computing the total income of the assessee for the relevant assessment year. In the case of Shivakami Mills (supra), the Supreme Court, affirmed the decision of the Madras High Court in Sivakami Mills Ltd. v. CIT, Madras, which was reported in 120 ITR 211. The learned counsel submitted that in view of the decision of the Supreme Court in India Cements Ltd. v. Commissioner of Income-tax, Madras, reported in 60 ITR 52, all the expenses incurred for the purpose of raising a loan were required to be allowed as revenue expenditure.

#. The learned counsel appearing for the Revenue, on the other hand, argued that the expenditure of these four items was incurred for the purpose of raising a loan which was to be utilised for purchase of machinery. Since the loan amount was to be used as a capital investment the amount spend for raising such loan became an integral part of the cost of acquisition of the capital asset, which resulted in an enduring benefit to the business of the assessee.

4.1 Reliance was placed by the learned counsel for the Revenue in support of this contention on CIT v. Bharat Suryodaya Mills co. Ltd., reported in 202 ITR 942, in which this Court held that if an expenditure is an integral part of the cost of acquisition of a capital

asset and not an integral part of profit earning process, such expenditure should be treated as a capital expenditure and not as revenue expenditure. It was held that payment of bank guarantee commission for purchasing machinery was, therefore, a capital expenditure. The Court followed its earlier decision in CIT v. Vallabh Glass Works Ltd. (supra), in which it was held that the test to be applied for finding out whether a particular expenditure is revenue expenditure or not is to find out whether the expenditure was so related to the carrying on or conduct of the business that it may be regarded as an integral part of profit-earning process. If the expenditure was so connected with the carrying on of the business that it may be regarded as an integral part of the profit-earning process, it should be treated as revenue expenditure. Any expenditure incurred for the acquisition of a capital asset or a right of permanent character or a benefit or advantage of an enduring nature, should be treated as capital expenditure. It was held that the payment of bank guarantee commission to the bank and the expenditure incurred in obtaining the letter of credit were necessary items of expenditure to bring the machineries, capital assets, into existence and to put them in working condition. These items of expenditure were incurred as an integral part of the payment of the cost price of the machineries and formed part of the cost of acquisition of the capital assets and, therefore, the expenditure must be regarded as capital expenditure irrespective of the time when the payment was made. This Court in Vallabh Glass dissented from the decision of the Andhra Pradesh High Court in Addl. CIT v. Akkamamba Textiles Ltd., reported in 117 ITR 294 and the decision of the Madras High Court in Sivakami Mills Ltd. v. CIT reported in 120 ITR 211 (Mad).

4.2 The learned counsel for the Revenue also referred to the decision of this Court in Mihir Textiles Ltd. v. CIT, reported in 225 ITR 327, in which following the decision of this Court in Vallabh Glass Works Ltd. (supra), it was held that the payment of bank guarantee commission for purchasing the machinery was capital expenditure. The decision of the Supreme Court in Punjab State Industrial Development Corporation Ltd. v. CIT, reported in 225 ITR 792, was referred to for the proposition that when an expenditure is made not only once and for all, but with a view to bringing into existence, an asset or an advantage for the enduring benefit of a trade, there is very good reason for treating such expenditure as properly attributable not to revenue but to capital. It was held that, this was,

however, not a strait-jacket formula and the question will have to be determined in the backdrop of the facts of each case. The test laid down can at best be a guide for determining whether a particular expenditure forms part of revenue expenditure or capital expenditure.

#. The question whether obtaining a loan can be regarded as an asset or advantage for enduring benefit of business of an assessee and whether the expenditure incurred in connection thereof towards the stamp duty, registration fees, lawyer's fees etc. could be claimed as business expenditure, came to be considered by the Supreme Court in India Cements Ltd.(supra). In that case, the assessee, during the accounting year, had obtained loan of Rs. 40.00 lacs from the Industrial Finance Corporation of India, which loan was secured by a charge on the fixed assets of the Company. The expenditure incurred to the tune of Rs. 84,633/- was incurred in connection with the said loan on the items of stamps, registration fee, charges for certified copy of the mortgage deed, indemnity deed, Vakil's fees in drafting deed and legal fees, as stated in the judgment. The ITO refused to allow the said deduction by observing that the amount of loan was paid in discharge of the amount borrowed and utilised on capital assets of the company. The Supreme Court rejected the contention that the loan obtained can be treated as an asset or advantage for the enduring benefit of the business of the assessee. It was held that a loan is a liability and has tobe repaid and it would be erroneous to consider the liability as an asset or an advantage. The Supreme Court opined that; (a) loan obtained is not an asset or advantage of an enduring nature; (b) that the expenditure was made for securing the use of money for a certain period; and (c) that it is irrelevant to consider the object with which the loan was obtained. (emphasis added). It was, therefore, held that in the circumstances of the case, the expenditure was revenue expenditure within Section 10(1)(xv) of the Indian Income-tax Act, 1922. Ratio of this decision was applied by the Supreme Court in Madras Industrial Investment Corporation Limited v. CIT, reported in 225 ITR 802,in which it was held that in light of the ratio laid down in India Cements Ltd. (supra), any liability incurred for the purpose of obtaining a loan would be revenue expenditure. In view of this clear pronouncement of the Supreme Court, the items of expenditure covered under the first four questions which admittedly were incurred for obtaining the loan amount could not be treated as capital expenditure, because, their direct nexus was with acquiring loan and not with acquiring of any asset. The

question nos. 1 to 4 are, therefore, answered in the negative in favour of the assessee and against the Revenue.

#. The Tribunal held that the foreign tour expenditure of Rs. 39,496/- and Rs. 85,411/-, incurred by the Managing Director of the Company was not allowable as revenue expenditure. In para-39 of its order, the Tribunal observed that according to it, no interference was called for in the order of the CIT (Appeals) inasmuch as the expenditure in question was on capital account and not of revenue account. It relied upon the ground in the memo of appeal reproduced in the said paragraph for reaching this conclusion. In the said ground, the appellant had taken up the contention that, the CIT (Appeals) had erred in disallowing these amounts which were foreign tour expenditure incurred by Managing Director of the Company "for the purpose of setting up a new line of production but nothing was materialised and no asset is created".

6.1 It would appear from the minutes of the 29th meeting of the Board of Directors held on 11.2.'83, a copy of which was on record that, the foreign tour expenses of Rs. 39,495.67 ps. were incurred on the foreign tour by the Managing Director to West Germany for the period from 25.4.83 to 8.5.83 in connection with discussions with M/s. Lupofresh who were going to supply know-how for the project of Breweries undertaken by M/s. Mohan Meakin, at Jammu & Kashmir. It would thus, appear that the project was not of the assessee but it was of M/s. Mohan Meakin. As regards the other amount, attention was drawn to item (b) of the said Agenda in which it was mentioned that the Hindustan Dorr Oliver were to take on lease the land and create Glass-lining manufacturing facility. It was noted that the management of the proposed unit was to be with the assessee (PFL) as per initially agreed terms and conditions. The Board directed Shri M.N. Patel (Director) to initiate the matter with HDO. It was stated that it would be necessary for Shri M.N. Patel to go to West Germany, U.S.A. and Canada for about 4/5 weeks and an approval was sought for this purpose under the said Agenda. In the communication to the Reserve Bank by HDO Ltd. in respect of the application of Shri M.N. Patel of Patel Filters Ltd. i.e. the assessee for foreign exchange, the Company had recommended the release of foreign exchange permit. It was sated that Shri M.N. Patel was was selected and entrusted with the task of setting up and managing of Patel Filters Ltd. because, he had production background and was an expert in manufacturing

and that the manufacturing expertise of the assessee was required by the HDO. It will thus be seen that the inference drawn by the Tribunal on the basis of the ground taken in the memo of appeal, reproduced in paragraph-39 of its order, was not warranted because, the said expenditure was not incurred for any new project of the assessee but was in connection with some project of the HDO. The finding of the Tribunal is reached without taking into consideration the aforesaid relevant material which was on the record of the case, and, therefore, is illegal. The question no. 5 is, therefore, answered in the negative in favour of the assessee and against the Revenue.

#. The learned counsel for the assessee has stated before us that the question no. 6 relating to the electric generator in respect of which claim was made at 100% depreciation on the ground that it was an energy saving device, is not pressed, because, over a period of time, full depreciation has been in fact, allowed as per the law. The question no. 6 therefore, remains unanswered on the ground that the assessee at whose instance it was referred, does not press for the same.

#. As regards the question which has been referred at the instance of the Revenue, arising from the order of the Tribunal, deleting the addition of Rs. 4,10,671/made by the ITO invoking the provision of Section 43B of the Income-tax Act, 1961, the matter is now fully covered by the decision of the Supreme Court in the case of Allied Motors (P) Ltd. v. CIT, reported in 224 ITR 677, in which, the Supreme Court held that the first proviso to Section 43B has to be treated as retrospective. In this view of the matter, the said question is answered in the affirmative in favour of the assessee and against the Revenue.

#. The Reference stands disposed of accordingly with no order as to costs.

[R.K. ABICHANDANI, J.] [K.M. MEHTA, J.]

pirzada/-